

IN THE UNITED STATES DISTRICT COURT  
FOR THE DISTRICT OF OREGON

QUANTUM TECHNOLOGY PARTNERS  
II, L.P., a Delaware limited  
partnership,

08-CV-376-BR

OPINION AND ORDER

Plaintiff,

v.

ALTMAN BROWNING AND COMPANY,  
an Oregon corporation; BAKER  
GROUP LLP; KAY E. ALTMAN, an  
individual; MICHAEL J. BAKER,  
an individual; DAVID M.  
BROWNING, an individual; and  
DOES 1 through 20,

Defendants,

and

APEX DRIVE LABORATORIES,  
INC., a Delaware corporation,

Nominal Defendant.

**JOHN S. STEWART**  
**ROBERT B. COLEMAN**  
**TYLER J. STORTI**  
Stewart Sokol & Gray, LLC  
2300 S.W. First Avenue  
Suite 200  
Portland, OR 97201  
(503) 221-0699

Attorneys for Plaintiff

**DAVID W. AXELROD**  
**DEVON ZASTROW NEWMAN**  
Schwabe Williamson & Wyatt, PC  
1600-1900 Pacwest Center  
1211 S.W. Fifth Avenue  
Portland, OR 97204  
(503) 222-9981

Attorneys for Defendants Altman Browning and Company,  
Kay E. Altman, and David M. Browning

**GARY I. GRENLEY**  
**PAUL H. TRINCHERO**  
**DAVID E. DEAN**  
Grenley Rotenberg Evans Bragg & Bodie PC  
1211 S.W. Fifth Avenue  
Suite 1100  
Portland, OR 97204  
(503) 241-0570

Attorneys for Defendants Baker Group LLP and Michael J.  
Baker

**DANIEL P. LARSEN**  
**JAMES M. BARRETT**  
Ater Wynne, LLP  
222 S.W. Columbia  
Suite 1800  
Portland, OR 97201  
(503) 226-1191

Attorneys for Nominal Defendant Apex Drive  
Laboratories, Inc.

**BROWN, Judge.**

This matter comes before the Court on the Motion to Dismiss (#14) of Nominal Defendant Apex Drive Laboratories, Inc.; the Motion to Strike (#13) of Defendants Baker Group LLP and Michael J. Baker; the Motion to Strike (#18) of Defendants Altman Browning and Company, Kay E. Altman, and David M. Browning; the Motion to Dismiss (#13) of Defendants Baker Group LLP and Michael J. Baker; and the Motion to Dismiss (#18) of Defendants Altman Browning and Company, Kay E. Altman, and David M. Browning.

For the reasons that follow, the Court **GRANTS** the Motion to Dismiss of Nominal Defendant Apex; **GRANTS in part** and **DENIES in part** the Motion to Strike of Defendants Baker Group LLP and Baker; **GRANTS in part** and **DENIES in part** the Motion to Strike of Defendants Altman Browning and Company, Altman, and Browning; **GRANTS** the Motion to Dismiss of Defendants Baker Group LLP and Baker; and **GRANTS** the Motion to Dismiss of Defendants Altman Browning and Company, Altman, and Browning.

#### **BACKGROUND**

The following facts are taken from the First Amended Complaint and Defendants' Memoranda in support of their Motions to Dismiss.

At some point before 2004, Plaintiff Quantum Technology Partners II, L.P., purchased shares in Primotive Corporation for

\$590,000.<sup>1</sup> On February 25, 2004, Primotive's Board of Directors (BOD) and a majority of its shareholders voted to sell substantially all of Primotive's assets to Apex. In exchange for Primotive's assets, Apex issued 51% of its stock to the former shareholders of Primotive. Through this transaction, Quantum became an Apex shareholder.

Also on February 25, 2004, Apex entered into a Services Agreement with Altman Browning and Company (ABCO) in which they agreed ABCO would develop Primotive's technology. Pursuant to the Services Agreement, Apex issued the remaining 49% of its outstanding stock to Baker Group. Baker Group then assigned 8.9% of those shares to Laughlin LLC "in exchange for the services ABCO agreed to perform for Apex."<sup>2</sup> Under the terms of the Services Agreement, ABCO was required to accomplish specifically enumerated "milestones" by January 1, 2006, on which date the Services Agreement terminated. If ABCO did not accomplish the milestones, the Apex shares transferred to Baker Group were subject to repurchase by Apex.

Baker, Altman, and Browning signed the Services Agreement on behalf of Apex in their capacities as Apex's President and Chief Executive Officer (CEO), Chief Financial Officer (CFO), and Chief

---

<sup>1</sup> At the time Quantum purchased its shares, Primotive was named Motile Corporation.

<sup>2</sup> Laughlin LLC is not identified or further described in the First Amended Complaint.

Technical Officer (CTO) respectively. Baker, Altman, and Browning also signed the agreement on behalf of ABCO acting in their capacities as ABCO's President and CEO, CFO, and CTO respectively.

In September 2004, Apex billed Holjeron Company \$50,000 for a prototype project completed for Holjeron. Apex then paid the \$50,000 to ABCO pursuant to the Services Agreement.

ABCO did not accomplish all of the milestones set out in the Services Agreement before January 1, 2006. Because ABCO did not accomplish all of the required milestones, Quantum delivered to the Baker Group and Laughlin a written consent of the majority of "non-interested shareholders" and payments required to repurchase their shares of Apex.

At an Apex shareholder meeting on February 16, 2006, Quantum moved to affirm the repurchase of the shares of Baker Group and Laughlin, and "[t]he motion carried based upon a count of shares owned by a majority of the disinterested stockholders." Also at that meeting, Quantum noted the Services Agreement had expired by its own terms on January 1, 2006. Baker, however, asserted the directors of Apex (*i.e.*, Baker, Altman, and Browning) had extended the Services Agreement at a BOD meeting in December 2005. In its First Amended Complaint, Quantum asserts the December 2005 BOD meeting never occurred and the document that Baker, Altman, and Browning provided to Quantum to establish that

the BOD meeting occurred was "created after-the-fact."

In December 2006, Porteon Electric Vehicles, Inc., made a "substantial investment" in Apex, and it became Apex's largest shareholder. On January 25, 2007, Brad Hippert, President of Porteon, was elected to Apex's BOD.

On February 15, 2007, Quantum filed a complaint in Multnomah County Circuit Court in which it brought claims for fraudulent inducement, breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, and unjust enrichment against the same Defendants in this action based on the same facts underlying this action. On May 23, 2007, Quantum voluntarily dismissed the Multnomah County action without prejudice.

On June 5, 2007, Quantum submitted to Apex a Demand for Investigation by Independent Directors of Apex Corporation in which Quantum demanded an investigation as to whether ABCO met the milestones of the Services Agreement; whether the Services Agreement deadline had been validly extended; when the notes of the December 2005 BOD meeting were created; whether the actions taken at the February 16, 2006, stockholder meeting were "valid"; whether Apex received \$50,000 from Holjeron and paid those funds to ABCO; and whether Defendants committed fraud, were self-dealing, breached their fiduciary duties, abused their control of Apex, grossly mismanaged Apex, wasted the corporate assets of

Apex, violated Delaware corporate law, illegally converted the assets of Apex, and/or misrepresented ABCO's experience and skill to carry out the Services Agreement.

On July 10, 2007, Porteon's CEO Ken Montler and CFO James Boehlke met with Barry Dickman, Quantum's owner and manager, to discuss the possibility of Porteon purchasing Quantum's shares of Apex. After the meeting, Dickman sent Boehlke an email in which he rejected Porteon's suggestion, noted the settlement offer with respect to the Multnomah County action before Quantum voluntarily dismissed that case, anticipated extensive legal fees if Quantum were to renew its action against Defendants, predicted discovery in such an action to be "monumental," and noted Dickman did not "see how Apex survives past about October" due to the costs of such an action and the fact that no one would invest in Apex under a cloud of litigation.

On September 6, 2007, the BOD formed a Special Investigative Committee (SIC) to investigate Quantum's June 5, 2007, Demand for Investigation.

On January 15, 2008, Hippert issued a report to Apex's shareholders in which he reviewed Quantum's June 2007 Demand. Hippert noted Apex's SIC hired independent outside counsel to investigate Quantum's Demand for Investigation and noted the SIC concluded pursuant to the investigation that "Quantum's claims have a tenuous foundation based on the facts." Hippert conceded

Apex's BOD "could have kept better records of its deliberations and "may have stretched the boundaries of its authority in some of its decisions." Hippert concluded, however, although the BOD "may have made decisions that affected its own interests, the ultimate outcome of its management of [Apex] during the time in question was fair to [Apex]." Finally, Hippert noted "the diversion of resources to pursue litigation rather than advancing the core business of Apex would surely cripple [Apex] and inhibit the progress we are making." Hippert concluded, therefore, Apex should not take further action on Quantum's Demand for Investigation.

On January 23, 2008, Dickman emailed the independent outside counsel to express his dissatisfaction with the investigation and to question outside counsel's objectivity. Outside counsel forwarded Dickman's email to Hippert, expressed his discomfort with responding directly to Dickman, and reiterated the "scope and design" of the investigation "were free from outside influence." Specifically, "Browning, Altman and Baker played no role in limiting or expanding the investigation, and neither did anyone else."

On March 25, 2008, Quantum filed a Complaint in this Court against Defendants in which it brought derivative claims for (1) breach of fiduciary duty; (2) abuse of control; (3) gross mismanagement; (4) waste of corporate assets; (5) specific

performance; and (6) unjust enrichment and direct claims for (a) conspiracy to violate the Racketeering Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. §§ 1961, *et seq.*, (b) violation of RICO, 18 U.S.C. § 1962(a), (b), and (c), and (c) fraudulent inducement.

On May 8, 2008, Quantum filed its First Amended Complaint to include more factual allegations to support its RICO claims.

On May 9, 2008, Defendants filed Motions to Dismiss this action.

On September 17, 2008, the Court issued an Order in which it advised the parties it would provide them with a "Draft Opinion and Order." The Court also permitted the parties to file supplemental briefs by September 26, 2008, to ensure the parties had an adequate opportunity to make their record as to the issues raised in Defendants' Motions.

On September 26, 2008, Plaintiff filed a supplemental brief in opposition in Defendants' Motions. Defendants declined to file supplemental materials.

#### **STANDARDS**

Dismissal under Federal Rule of Civil Procedure 12(b)(6) for failure to state a claim is proper only if the pleadings fail to allege enough facts so as to demonstrate a plausible entitlement to relief. *Bell Atlantic v. Twombly*, \_\_\_ U.S. \_\_\_, 127 S. Ct.

1955, 1964-65 (2007).

While a complaint attacked by a Rule 12(b)(6) motion to dismiss does not need detailed factual allegations, a plaintiff's obligation to provide the "grounds" of his "entitle[ment] to relief" requires more than labels and conclusions, and a formulaic recitation of the elements of a cause of action will not do. Factual allegations must be enough to raise a right to relief above the speculative level on the assumption that all the allegations in the complaint are true (even if doubtful in fact).

*Id.* at 1964-65. The court accepts as true the allegations in the complaint and construes them in favor of the plaintiff.

*Intri-Plex Tech., Inc. v. Crest Group, Inc.*, 499 F.3d 1048, 1050 n.2 (9<sup>th</sup> Cir. 2007). "The court need not accept as true, however, allegations that contradict facts that may be judicially noticed by the court, and may consider documents that are referred to in the complaint whose authenticity no party questions." *Shwarz v. United States*, 234 F.3d 428, 435 (9<sup>th</sup> Cir. 2000)(citations omitted).

Federal Rule of Civil Procedure 8(a) generally provides a pleading that sets forth a claim must contain "a short and plain statement of the claim showing the pleader is entitled to relief." The plaintiff need only provide in the initial pleading sufficient factual allegations to give the defendant "fair notice" of the claims against it and the grounds on which the claim is based. *Conley*, 355 U.S. at 47.

Federal Rule of Civil Procedure 9(b), however, requires all

allegations of fraud to be stated "with particularity." The heightened pleading standard of Rule 9(b) also applies to RICO claims that include allegations of fraudulent activities as predicate acts of racketeering. *Odom v. Microsoft Corp.*, 486 F.3d 541, 553 (9<sup>th</sup> Cir. 2007).

To satisfy the additional burdens imposed by Rule 9(b), the plaintiff must allege "the time, place and nature of the alleged fraudulent activities." *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9<sup>th</sup> Cir. 1995)(quotation omitted). In addition, Rule 9(b)

does not allow a complaint to merely lump multiple defendants together but require[s] plaintiffs to differentiate their allegations when suing more than one defendant . . . and inform each defendant separately of the allegations surrounding his alleged participation in the fraud.

*Swartz v. KPMG LLP*, 476 F.3d 756, 764-65 (9<sup>th</sup> Cir. 2007)

(quotation omitted). "In the context of a fraud suit involving multiple defendants, a plaintiff must, at a minimum, 'identif[y] the role of [each] defendant[ ] in the alleged fraudulent scheme.'" *Id.* at 765 (quoting *Moore v. Kayport Package Express, Inc.*, 885 F.2d 531, 541 (9<sup>th</sup> Cir. 1989)).

In addition, Federal Rule of Civil Procedure 23.1, which governs actions in which "one or more shareholders or members of a corporation or an unincorporated association bring a derivative action to enforce a right that the corporation or association may properly assert but has failed to enforce," requires the plaintiff who asserts a derivative claim to verify his complaint

and to

- (1) allege that the plaintiff was a shareholder or member at the time of the transaction complained of, or that the plaintiff's share or membership later devolved on it by operation of law;
- (2) allege that the action is not a collusive one to confer jurisdiction that the court would otherwise lack; and
- (3) state with particularity:
  - (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and
  - (B) the reasons for not obtaining the action or not making the effort.

To determine whether a complaint meets the pleading standards of Rule 23.1, the court must look to the law of the state of the company's incorporation. *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 989-90 (9<sup>th</sup> Cir. 1999).

If a claim is dismissed pursuant to Rule 12(b)(6), Rule 9(b), or Rule 23.1, the court should grant the plaintiff leave to amend his complaint unless the court determines the allegation of other facts consistent with the operative pleading could not possibly cure the deficiency. *Schreiber Distrib. Co. v. Serv-Well Furniture Co.*, 806 F.2d 1393, 1401 (9<sup>th</sup> Cir. 1986). See also *Reddy v. Litton Indus.*, 912 F.2d 291 (9<sup>th</sup> Cir. 1990), cert. denied, 502 U.S. 921 (1991); *In re Openwave Sys., Inc. Shareholder Derivative Litig.*, 503 F. Supp. 2d 1341, 1351 (N.D.

Cal. 2007))(dismissed complaint for failure to meet the requirements of Rule 23.1 with leave to amend complaint).

**MOTION TO DISMISS OF NOMINAL DEFENDANT APEX DRIVE  
LABORATORIES, INC. (#14)**

Apex moves to dismiss Quantum's derivative claims (*i.e.*, Quantum's claims for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, specific performance, and unjust enrichment) on the grounds that (1) Quantum does not fairly and adequately represent the interests of Apex's other similarly situated shareholders, (2) Quantum fails to plead with particularity as required under Rule 23.1 that its Demand for Investigation was wrongfully refused by the Apex BOD, and (3) the derivative claims are unverified as required under Rule 23.1.

**I. Fair and adequate representation of the interests of Apex's shareholders.**

Apex contends Quantum does not fairly and adequately represent the interests of Apex's other similarly situated stockholders because (1) Quantum's conduct has been vindictive toward other Apex shareholders; (2) Quantum seeks to rescind its acceptance of Apex's shares, which conflicts with its interests as a shareholder; and (3) Quantum's interest in its direct claims far exceed and conflict with its interest in its derivative claims.

### A. Standards.

Derivative actions are brought by a shareholder to enforce a corporation's rights when the corporation itself fails to enforce its rights. *See Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 528-34 (1984). As noted, derivative actions are subject to the procedural requirements of Rule 23.1, which provides a derivative action "may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association maintained."

As noted, to determine whether Quantum's First Amended Complaint meets the pleading standards of Rule 23.1, the Court must look to the law of the state of the company's incorporation. *Silicon Graphics*, 183 F.3d at 989-90. Apex is incorporated in Delaware, and, therefore, the Court must apply Delaware law.

Under Delaware law, "Rule 23.1 has been interpreted as requiring that a court consider any extrinsic factors which might indicate that a representative might disregard the interests of the other members of the class." *Emerald Partners v. Berlin*, 564 A.2d 670, 673 (Del. Ch. 1989)(citing *Davis v. Comed., Inc.*, 619 F.2d 588 (6<sup>th</sup> Cir. 1980), and *Blum v. Morgan Guar. Trust Co. of New York*, 539 F.2d 1388 (5<sup>th</sup> Cir. 1976)). For purposes of Defendants' Motions to Dismiss as to the issue of Quantum's

adequacy as a shareholder representative, the Court, therefore, may consider matters outside of the complaint.

"Among the elements which the courts have evaluated in considering whether the derivative plaintiff meets Rule 23.1's representation requirements are, economic antagonisms between representative and class; the remedy sought by the plaintiff in the derivative action; indications that the named plaintiff was not the driving force behind the litigation; plaintiff's unfamiliarity with the litigation; other litigation pending between the plaintiff and defendants; the relative magnitude of plaintiff's personal interests as compared to his interest in the derivative action itself; plaintiff's vindictiveness toward the defendants and, finally, the degree of support plaintiff was receiving from the shareholders he purported to represent."

\* \* \*

"Typically, the elements are intertwined or interrelated, and it is frequently a combination of factors which leads a court to conclude that the plaintiff does not fulfill the requirements of 23.1 (although often a strong showing of one way in which the plaintiff's interests are actually inimical to those he is supposed to represent fairly and adequately, will suffice in reaching such a conclusion)."

*Id.* (quoting *Davis*, 619 F.2d at 593-95). "The determination of whether a derivative plaintiff will adequately represent the interests of the other class members, therefore, involves a multidimensional examination, although a strong showing of one factor, depending upon the circumstances, may be sufficient in itself to disqualify a plaintiff who desires to represent a class." *Id.* at 673-74.

A shareholder may maintain a derivative action even

though "it does not have the support of a majority of the corporation's shareholders or even the support of all the minority stockholders." *Id.* at 674 (citing *Nolen v. Shaw-Walker Co.*, 449 F.2d 506, 508, n.4 (6<sup>th</sup> Cir. 1971)). "The true measure of adequacy of representation, therefore, is not how many shareholders the derivative plaintiff represents, but rather, how well he advances the interests of the other similarly situated shareholders." *Id.* (citing *Schupack v. Covelli*, 512 F. Supp. 1310 (W.D. Pa. 1981), and *Halstead Video, Inc. v. Guttillo*, 115 F.R.D. 177 (N.D. Ill. 1987)).

Courts will not disqualify a plaintiff in a derivative action "simply because he may have interests which go beyond the interests of the class and, as long as the plaintiff's interests are coextensive with the class, his representation of the class will not be proscribed." *Id.* (citing *Recchion, Westinghouse Elec. Corp. v. Kirby*, 637 F. Supp. 1309 (W.D. Pa. 1986)). In addition, "purely hypothetical, potential or remote conflicts of interest will not disqualify a derivative plaintiff." *Id.* (citing *Youngman v. Tahmoush*, 457 A.2d 376 (Del. Ch. 1983), and *Vanderbilt v. Geo-Energy Ltd.*, 725 F.2d 204 (3d Cir. 1983)).

A defendant has the burden of proof in a motion to disqualify a derivative plaintiff and he must show that a serious conflict exists, by virtue of one factor or a combination of factors, and that the plaintiff cannot be expected to act in the interests of the others because doing so would harm his other interests. . . . In effect, the defendant must show a substantial likelihood that

the derivative action is not being maintained for the benefit of the shareholders.

*Id.*

## **B. Analysis.**

Apex contends Quantum's personal interests greatly outweigh its interest in the derivative action: *i.e.*, Quantum seeks to recover at least its initial Primotive investment of \$595,000, but only seeks to recover the \$50,000 paid to ABCO on behalf of Apex through its derivative claim. Apex also contends Quantum has not received any support from the shareholders it purports to represent, and, in fact, Quantum has acted vindictively toward Apex's other shareholders. Finally, Apex contends Quantum seeks to rescind its acceptance of Apex's shares as a remedy for its direct claim even though Quantum would then no longer be an Apex shareholder, and, according to Apex, would, therefore, lack standing to bring a derivative action.

The Court questions whether Apex's assertion with respect to Quantum's standing is correct. Rule 23.1(b) requires only that the complaint "allege . . . the plaintiff was a shareholder or member at the time of the transaction complained of." In its First Amended Complaint, Quantum alleges it was a shareholder in Apex at the time of the events in question. These allegations satisfy Rule 23.1.

With respect to vindictiveness, the Delaware court noted in *Emerald Partners* that

[i]nadequacy as a class representative is not made out merely because of a discordant relation between plaintiff and defendants. To the contrary, this may inspire plaintiff to be an even more forceful advocate. That plaintiff may have amorphous hostile feelings against defendants is not in itself relevant to the court given the absence of any concrete fact which reveals a conflict of interest between plaintiff and the class sufficient to make his representation inadequate.

564 A.2d 676 (quotation omitted). Here Apex points to the fact that Quantum threatened on July 10, 2007, to litigate the matters at issue here, to subject Apex through litigation to the high cost of "monumental" discovery, and to place Apex "under a cloud of litigation" that would cause investors not to invest in Apex to the extent that Quantum acknowledged it did not "see how Apex survive[d] past October." These facts establish Quantum had more than "amorphous hostile feelings" against Apex's other shareholders and reveal a concrete conflict of interest between Quantum and Defendants. In addition, the record does not reflect any other Apex shareholder supports Quantum's efforts to rescind Apex's stock transfer or to obtain any of the other relief sought by Quantum.

Based on this record, the Court finds Apex has established that Quantum will individually profit from this litigation to the detriment of other similarly situated Apex shareholders as well as to the detriment of Apex and that the interests of Quantum diverge from those of Apex and its

shareholders. The Court, therefore, concludes Apex has established Quantum does not fairly and adequately represent the interests of Apex's other similarly situated shareholders.

Accordingly, the Court grants Apex's Motion to Dismiss Quantum's derivative claims for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, specific performance, and unjust enrichment.

## **II. Refusal of Quantum's Demand for Investigation.**

Even if the Court concluded Quantum would fairly and adequately represent the interests of Apex's other similarly situated shareholders, the Court would have to grant Apex's Motion to Dismiss on the ground that Quantum has not alleged wrongful refusal of its Demand for Investigation with particularity.

Rule 23.1 requires a complaint in a shareholder-derivative action to

(3) state with particularity:

(A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and

(B) the reasons for not obtaining the action or not making the effort.

The demand requirement of Rule 23.1 is based on the basic premise that "directors, rather than shareholders, manage the business and affairs of the corporation." *Spiegel v. Buntrock*, 571 A.2d

767, 772-73 (Del. Supr. 1990). "The decision to bring a law suit or to refrain from litigating a claim on behalf of a corporation is a decision concerning the management of the corporation. Consequently, such decisions are part of the responsibility of the board of directors." *Id.* at 773 (citation omitted). Derivative actions are "[i]n essence, . . . a challenge to a board of directors' managerial power." *Id.* (citation omitted).

Thus, by its very nature, "the derivative action impinges on the managerial freedom of directors." *Pogostin v. Rice*, 480 A.2d 619, 624 (Del. Supr. 1984). In fact, the United States Supreme Court has noted that the shareholder derivative action "could, if unrestrained, undermine the basic principle of corporate governance that the decisions of a corporation-including the decision to initiate litigation-should be made by the board of directors or the majority of shareholders." *Daily Income Fund, Inc. v. Fox*, 464 U.S. 523, 531 (1984)(citing *Hawes v. Oakland*, 104 U.S. 450 (1882)). See *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d 726, 730 (Del Supr. 1988).

"Because the shareholders' ability to institute an action on behalf of the corporation inherently impinges upon the directors' power to manage the affairs of the corporation the law imposes certain prerequisites on a stockholder's right to sue derivatively." *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d at 730 (citing *Pogostin v. Rice*, 480 A.2d at 624); *Aronson v. Lewis*, 473 A.2d at 811. . . . Rule 23.1 requires that shareholders seeking to assert a claim on behalf of the corporation must first exhaust intracorporate remedies by making a demand on the directors to obtain the action desired, or to plead with particularity why demand is excused. *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d at 730. See also *Aronson v. Lewis*, 473 A.2d at 811-812; *Zapata Corp. v. Maldonado*, 430 A.2d at 783.

The purpose of pre-suit demand is to assure that the stockholder affords the corporation the opportunity to address an alleged wrong without litigation, to decide whether to invest the resources of the corporation in litigation, and to control any litigation which does occur. *Kaplan v. Peat, Marwick, Mitchell & Co.*, 540 A.2d at 730. "[B]y promoting this form of alternate dispute resolution, rather than immediate recourse to litigation, the demand requirement is a recognition of the fundamental precept that directors manage the business and affairs of corporations." *Aronson v. Lewis*, 473 A.2d at 812.

*Id.*

With respect to the level of particularity required for a demand under Rule 23.1, the Court, as noted, must apply Delaware law. *Silicon Graphics*, 183 F.3d at 989-90. Under Delaware law, when a court analyzes whether a demand complies with the requirements of Rule 23.1, the

court limits its consideration to the particularized facts alleged in the complaint; the burden is thus more onerous than that required to withstand an ordinary motion to dismiss. . . . "Conclusory allegations of fact or law [which are] not supported by allegations of specific fact may not be taken as true."

*Belova v. Sharp*, No. CV 07-299-MO, 2008 WL 700961, at \*3 (D. Or. March 13, 2008)(citing *Aronson v. Lewis*, 473 A.2d 805, 813-15 (Del. 1984), overruled on other grounds by *Brehm v. Eisner*, 796 A.2d 244 (Del. 2000), and quoting *Levine v. Smith*, 591 A.2d 194, 207 (Del. 1991)).

In its First Amended Complaint, Quantum alleges:

Plaintiff did not make a demand on the Apex Board to institute this action, because such a

demand would have been futile, wasteful, and a useless act. . . . In the alternative, on or about June 5, 2007, plaintiff demanded that the board take the action(s) demanded in this Complaint. The Apex Board agreed to investigate, as demanded. . . . The Apex Board's investigation was inadequate.

\* \* \*

None of the directors are disinterested, because they each face a substantial likelihood of liability for their breaches of fiduciary duty to Apex. The Board's decisions were not products of valid business judgment and the transactions were

not fair and reasonable to the Company. Thus, demand was futile as to each of the directors.

First Am. Compl. ¶¶ 42-43.

With respect to Quantum's allegation that it made a demand for investigation but the investigation was inadequate or, in the alternative, that Quantum did not make a demand for investigation because such demand would have been futile, Delaware courts have held a derivative plaintiff cannot allege futility after it has made such a demand. In *Spiegel*, the Delaware Supreme Court rejected the plaintiff's argument that "demand should be encouraged by permitting a demand to be made, while at the same time permitting the argument, that demand was excused, to be preserved." 571 A.2d at 774-75. The court concluded under Delaware law that "[b]y making a demand, a stockholder tacitly acknowledges the absence of facts to support a finding of futility. Thus, when a demand is made, the question of whether demand was excused is moot." *Id.* at 775. "A shareholder who

makes a demand can no longer argue that demand is excused." *Id.*

Here Quantum alleges it "demanded that [Apex's BOD] take the action(s) demanded in this Complaint." Because Quantum asserted it made a Demand for Investigation to Apex's BOD, Quantum must state with particularity "the reasons for not obtaining the action [sought]" pursuant to Rule 23.1. In other words, Quantum must allege with particularity that Apex wrongfully refused Quantum's demand. See *Grimes v. DSC Commc'n Corp.*, 724 A.2d 561, 565 (Del. Ch. 1998) ("A stockholder wishing to pursue a derivative action after a board of directors has refused a pre-suit demand must allege with particularity facts sufficient to create a reasonable doubt that the corporation's board wrongfully refused the demand.").

Quantum does not specifically allege in its First Amended Complaint that its demand was wrongfully refused. Instead Quantum alleges the investigation was inadequate, the BOD is "not disinterested," the BOD's decisions are not the products of valid business judgment, and the transactions were not fair and reasonable for the company. The Court concludes these allegations are merely generalized conclusory statements and do not satisfy the specificity requirements of Rule 23.1.

Accordingly, the Court grants Apex's Motion to Dismiss Quantum's claims for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, specific

performance, and unjust enrichment on the additional ground that Quantum has not satisfied the demand requirements of Rule 23.1 to plead with particularity "the reasons for not obtaining the action or not making the effort."

**MOTION TO STRIKE OF DEFENDANTS ABCO, ALTMAN, AND  
BROWNING (#18) and MOTION TO STRIKE OF DEFENDANTS  
BAKER GROUP, LLP, AND MICHAEL J. BAKER (#13)**

ABCO, Altman, Browning, Baker, and Baker Group move to strike a portion of paragraph 16 and all of paragraph 19 of Quantum's First Amended Complaint.

**I. Portion of Paragraph 16.**

Defendants move to strike the portion of paragraph 16 in which Quantum alleges the Individual Defendants "reasonably should have known." Defendants contend this phrase sets out the incorrect level of scienter required to support a claim for fraudulent inducement.

The Court, however, does not look to the complaint for its legal standards. The Court will apply the appropriate legal standard regardless of Quantum's allegations in its First Amended Complaint.

Accordingly, the Court denies Defendants' Motions to Strike as to the phrase "reasonably should have known" from paragraph 16 of Quantum's First Amended Complaint.

## II. Paragraph 19.

Defendants move to strike paragraph 19 of Quantum's First Amended Complaint in its entirety.

In paragraph 19, Quantum alleges:

At the time of the transaction, Plaintiff Quantum asked the attorney for Apex, who was acting in the course and scope of his agency for Apex, whether the Individual Defendants, as a result of their being the sole directors of Apex, would be precluded from voting to renew, extend or modify the services agreement if ABCO did not meet the specified milestones. The attorney told Plaintiff Quantum that under Delaware corporate law, they could not vote to renew, extend or modify the services agreement because they had a conflict of interest and were not disinterested directors. This attorney had special knowledge, skill and experience in Delaware corporate law, which Plaintiff Quantum lacked. As a result, Plaintiff Quantum was entitled to rely, and in fact did reasonably and justifiably rely on this representation. This representation was a material misrepresentation of fact and law, which Plaintiff Quantum relied upon to its detriment in voting to proceed with the transaction.

Defendants contend the Court should strike this paragraph because Quantum cannot attribute the alleged statement of Apex's counsel to any defendant other than Apex, and Quantum cannot assert a direct claim against Apex for misrepresentation or fraud at the same time that it asserts a derivative claim on behalf of Apex.

Quantum, in turn, contends it alleges the facts in paragraph 19 as background rather than as the basis for any claim. As Defendants note, however, the last two sentences

of paragraph 19 suggest Quantum bases the element of reliance in its fraudulent-inducement claim on the statements allegedly made by Apex's counsel. Thus, according to Defendants, these allegations go beyond background facts.

Because Quantum is asserting derivative claims on behalf of Apex, and, therefore, Quantum cannot assert a direct claim against Apex for misrepresentation or fraud, the Court grants Defendants' Motions to Strike as to the last two sentences of paragraph 19 of the First Amended Complaint.

**MOTION TO DISMISS OF DEFENDANTS ABCO, ALTMAN, AND BROWNING (#18) and MOTION TO DISMISS OF DEFENDANTS BAKER GROUP, LLP, AND MICHAEL J. BAKER (#13)**<sup>3</sup>

Quantum brings nine claims against ABCO, Altman, Browning, Baker, and Baker Group: six in its capacity as a derivative plaintiff (breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, specific performance, and unjust enrichment) and three direct claims (conspiracy to violate RICO, violations of RICO, and fraudulent inducement).

ABCO, Altman, and Browning move to dismiss all of Quantum's claims on the ground that Quantum does not fairly and adequately represent Apex's other shareholders in its derivative claims.

---

<sup>3</sup> Defendants Baker Group and Michael J. Baker filed a separate Motion to Dismiss in which they merely join the Motion to Dismiss of Defendants ABCO, Altman, and Browning.

Here all Defendants (with the exception of Apex) move to dismiss Quantum's direct claims on the grounds that (1) Quantum failed to plead sufficient predicate acts to state a RICO claim; (2) Quantum did not plead its RICO claims with sufficient particularity; (3) Quantum has not plead fraudulent inducement with sufficient particularity; and (4) Quantum's claims for abuse of control, gross mismanagement, and waste of corporate assets do not state a claim separate from Quantum's claim for breach of fiduciary duty.

#### **I. Derivative Claims.**

For the reasons noted above, the Court concludes Quantum does not fairly and adequately represent the interest of Apex's other shareholders. Accordingly, the Court grants the Motions to Dismiss of ABCO, Altman, Browning, Baker, and Baker Group as to Quantum's derivative claims for breach of fiduciary duty, abuse of control, gross mismanagement, waste of corporate assets, specific performance, and unjust enrichment.

#### **II. Portions of Quantum's RICO claims are preempted by the Private Securities Litigation Reform Act (PSLRA).**

Quantum brings claims against Defendants other than Apex for violation of and conspiracy to violate §§ 1962(a), (b), and (c) of RICO. "To state a RICO claim [under § 1962(a), (b), or (c)], one must allege a pattern of racketeering activity, which requires at least two predicate acts." *Clark v. Time Warner Cable*, 523 F.3d 1110, 1116 (9<sup>th</sup> Cir. 2008)(citations omitted).

Section 107 of the PSLRA amended RICO to prohibit the use of securities fraud as a predicate act. *Swartz*, 476 F.3d at 761. After enactment of the PSLRA, RICO provides in pertinent part that

[a]ny person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor . . . except that no person may rely upon any conduct that would have been actionable as fraud in the purchase or sale of securities to establish a violation of section 1962.

18 U.S.C. § 1964(c).

Congress enacted the PSLRA to "deprive plaintiffs of the right to bring securities fraud based RICO claims," *Scott v. Boos*, 215 F.3d 940, 945 (9<sup>th</sup> Cir. 2000), and to "prevent a plaintiff from 'plead[ing] other specified offenses, such as mail or wire fraud, as predicate acts under civil RICO if such offenses are based on conduct that would have been actionable as securities fraud.'" *Sell v. Zions First Nation Bank*, No. CV 05 0684 PHX SRB, 2006 WL 322469, at \*8 (D. Ariz. Feb. 9, 2006) (quoting *Bald Eagle Area Sch. Dist. v. Keystone Fin., Inc.*, 189 F.3d 321, 324 (3d Cir. 1999)). See also *Seippel v. Jenkins & Gilchrist, P.C.*, 341 F. Supp. 2d 363, 372 (S.D.N.Y. 2004) ("In amending RICO, Congress was clear in stating that the PSLRA was meant to eliminate the possibility that litigants might frame their securities claims under a mail or wire fraud claim."); *Swartz v. KPMG, LLC*, 401 F. Supp. 2d 1146, 1151 (W.D. Wash. 2004)

("The rule that a plaintiff cannot assert a RICO claim based on predicate acts that sound in securities fraud is applicable even if, as is the case here, the claim is pled as a matter of mail fraud or wire fraud.")(citing *Howard v. Am. Online, Inc.*, 208 F.3d 741, 749-50 (9<sup>th</sup> Cir. 2000)).

Here Defendants contend the conduct Quantum relies on as the basis for its RICO claims is conduct actionable as securities fraud, and, therefore, it may not form the basis for predicate acts under RICO. According to Defendants, therefore, Quantum has not adequately pled his RICO claims.

When determining whether conduct alleged in the context of a RICO claim is "conduct . . . actionable as fraud in the purchase or sale of securities," courts have looked to the Securities Exchange Act of 1983, 15 U.S.C. § 78j(b), which makes it "unlawful for any person . . . [t]o use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [SEC] may prescribe." Rule 10b-5 implements this provision and forbids the use "in connection with the purchase or sale of any security" of "any device, scheme, or artifice to defraud" or any other "act, practice, or course of business" that "operates . . . as a fraud or deceit." 17 C.F.R. § 240.10b-5.

In *S.E.C. v. Zanford*, the Supreme Court explained these

provisions "should be construed not technically and restrictively, but flexibly to effectuate [the Act's] remedial purposes." 535 U.S. 813, 820 (2002). In *Zanford*, the defendant, a securities broker, persuaded William Wood to open an investment account and to give the defendant a general power of attorney to engage in securities transactions for Wood's benefit without prior approval. *Id.* at 815. Several years later, an audit revealed the defendant had transferred money from Wood's account to accounts controlled by the defendant on over 25 occasions. *Id.* The defendant was indicted on 13 counts of wire fraud based on allegations that the defendant sold securities in Wood's account and made personal use of the proceeds. *Id.* at 815-16. The Securities and Exchange Commission (SEC) then brought a civil complaint against the defendant in which it alleged the defendant violated § 10(b) of the Securities Exchange Act when he engaged in a scheme to defraud Wood and misappropriated Wood's securities. *Id.* at 816. The Supreme Court accepted *certiorari* to determine whether the defendant's alleged fraudulent conduct occurred "in connection with the purchase or sale of any security" within the meaning of § 10(b) and Rule 10b-5. The defendant asserted he had not committed fraud "in connection with" the sale of securities because the "sales themselves were perfectly lawful" and were not "in connection with" the misappropriation of the proceeds from those sales. *Id.* at 820.

The Court rejected the defendant's argument and reasoned:

[T]he securities sales and the respondent's fraudulent practices were not independent events. This is not a case in which, after a lawful transaction had been consummated, a broker decided to steal the proceeds and did so. Nor is it a case in which a thief simply invested the proceeds of a routine conversion in the stock market. Rather, the respondent's fraud coincided with the sales themselves. . . . [E]ach sale was made to further respondent's fraudulent scheme. . . . In the aggregate, the sales are properly viewed as a course of business that operated as a fraud or deceit on a stockbroker's customer.

*Id.* at 820-21. The Court noted the "in connection with" requirement for securities fraud was "extremely broad" and only proof of "a fraudulent scheme in which the securities transactions and breaches of fiduciary duty coincide" is necessary to satisfy that requirement. *Id.* at 825.

In paragraphs 75-76 of its First Amended Complaint, Quantum alleges the following facts in support of its RICO claims:

Under 18 U.S.C. § 1962(a), Defendants unlawfully received income derived, directly and indirectly, from a pattern of racketeering activity and used and invested, directly and indirectly, all or part of such income (and/or proceeds therefrom) in acquisition of interests in and the establishment and operation of an enterprise engaged in, and the activities of which affect, interstate or foreign commerce. Under 18 U.S.C. § 1962(b), Defendants also, through a pattern of racketeering activity acquired and maintained, directly and indirectly, interest in and control of an enterprise that engaged in, and the activities of which affect, interstate or foreign commerce. Under 18 U.S.C. § 1962(c), Defendants, particularly the Individual Defendants and DOES, were employed by and associated with an enterprise engaged in, or the activities of which

affect, interstate or foreign commerce, to conduct and participate, directly and indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity.

\* \* \*

The pattern of racketeering activity in which Defendants engaged included a pattern of conduct in violation of 18 U.S.C. §§ 1341 (relating to mail fraud) and 1343 (relating to wire fraud), in that Defendants, having devised or intending to devise their scheme or artifice to defraud Plaintiff and obtain money and property by means of false and fraudulent pretenses, representations and promises, and for the purpose of executing such scheme or artifice (or attempting to do so), upon information and belief placed matters and things in the mail (and/or private or commercial interstate carrier) and, upon information and belief, transmitted or caused to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, various writings, signals, pictures or sounds for the purpose of executing such scheme or artifice. Such schemes or artifices involved the following pattern of activity, the details of which are more fully described above:

a. Fraudulently proposing, establishing and inducing Plaintiff into becoming involved with the transaction(s) among and between Primotive, Apex, ABCO, Baker Group and Laughlin, LLC;

b. Fraudulently submitting invoices to Apex and otherwise billing Apex (and crediting ABCO) for work allegedly performed by ABCO when, in fact, little (if any) useful work was actually done, no progress was made, waste and inefficiency were rewarded, no results were forthcoming and invoices and bills were otherwise fraudulently falsified;

c. Fraudulently representing that the services agreement had been approved by a legitimately authorized vote of the Apex board, falsifying after-the-fact Apex board minutes allegedly reflecting that extension, and otherwise

wrongfully acting without proper authority and with conflicts of interest to extend the services agreement; and

d. Fraudulently causing money to be paid to and credit to be taken by ABCO purportedly under the services agreement for the work billed by Apex to Holjeron and the false representations and communications connected therewith.

As noted, Congress bars a plaintiff from asserting claims under RICO that involve securities fraud to "prevent a plaintiff from pleading other specified offenses, such as mail fraud or wire fraud, as predicate acts under RICO if such offenses are based on conduct that would have been actionable as securities fraud." *Bald Eagle*, 189 F.3d at 327. In addition, the PSLRA prohibits any person from "us[ing] or employ[ing], . . . any . . . deceptive device or contrivance" in connection with the purchase or sale of any security.

Here Defendants note the transaction referenced in paragraph 76(a) is the one in which Quantum acquired Apex shares. According to Defendants, even though Quantum couches its RICO claims as based on mail and wire fraud, the predicate acts specifically alleged in paragraph 76(a) to support these claims occur in connection with the sale of securities, and the alleged mail and wire fraud at issue coincides with the transfer of securities. Defendants contend, therefore, that Quantum is barred from relying on the conduct alleged in paragraph 76(a) to establish a RICO claim. The Court agrees.

Accordingly, the Court concludes the PSLRA and RICO bar Quantum from relying on the allegations in paragraph 76(a) of the First Amended Complaint as a predicate act to support his RICO claims.

### **III. Quantum lacks standing to bring derivative RICO claims.**

Defendants assert the predicate acts alleged by Quantum in paragraphs 76(b)-(d) of its First Amended Complaint are derivative in nature, and, therefore, Quantum cannot base its RICO claims on these allegations.

"In order to state a claim for a RICO violation, a plaintiff must plead facts that show the defendant's violation of § 1962 was the proximate cause of the plaintiff's injury." *Altamont Summit Apartments, LLC v. Wolff Prop., LLC*, No. Civ. 01-1260-BR, 2002 WL 926264, at \*13 (D. Or. Feb. 13, 2002)(citing *Hamid v. Price Waterhouse*, 51 F.3d 1411, 1419 (9<sup>th</sup> Cir. 1995), cert. denied, 516 U.S. 1047 (1996)). "A plaintiff may not sue directly if his injury is derived wholly from an injury to a third party." *Id.* (citing *Holmes v. Sec. Investor Prot. Corp.*, 503 U.S. 258, 268-69 (1992)).

Thus, shareholders may not sue for the harm to the class of shareholders as a whole unless the plaintiffs can show either: (1) an injury distinct from that of the other shareholders or (2) a special duty owed by the defendant to the plaintiffs that is different from the duties owed by the defendant to the corporate entity.

*Id.* (citing *Sparling v. Hoffman Constr. Co., Inc.*, 864 F.2d 635,

640 (9<sup>th</sup> Cir. 1988)). See also *Hamid*, 51 F.3d at 1419-20 (As to shareholders asserting a RICO claim when "the harm is to all the members, and the injuries claimed by the plaintiffs are not separate and distinct from those to shareholders . . . generally, the RICO claim is derivative and there is no standing on the part of the shareholders . . . to assert it."). A shareholder "generally" only sustains injury because he is a shareholder of the corporation, and his injury "is derivative of the injury of the corporation and is not caused[, therefore,] by the RICO violations." *Hamid*, 51 F.3d at 1420 (citation omitted). "Permitting [shareholders] to bring individual actions for such injuries would invariably impair the rights of other [shareholders]." *Id.* (quotation omitted).

Here in paragraphs 76(b)-(d), Quantum asserts Defendants fraudulently overbilled Apex for ABCO's services, fraudulently caused Apex to pay to ABCO the \$50,000 Apex received from Holjeron, and fraudulently represented the Apex BOD had extended the Services Agreement. Although Quantum does not specifically identify the damages it suffered as a result of Defendants' alleged RICO violations, Quantum states in paragraph 33 of the First Amended Complaint:

As a result of the defendants' improprieties, Apex has expended significant sums, which include, but are not limited to, credits to ABCO for work under the services agreement, when ABCO has utterly failed to perform and payment of \$50,000 to ABCO for work purportedly done "under" the service

agreement for services billed to Holjeron, and cancellation of the Company's repurchase rights, which resulted in dilution of shareholder equity.

These described damages as well as the facts supporting them were allegedly suffered by Apex directly. Thus, any damages Quantum sustained as a result of the acts alleged in paragraphs 76(b)-(d) were solely derivative in nature. As in *Sparling*, the "wrong alleged [here] is a fraud on the corporation," and Quantum has not alleged any injury distinct from the injury suffered by other shareholders as a result of the acts set out in paragraphs 76(b)-(d). Quantum also does not allege any special duty that Defendants, officers, and shareholders of Apex owed to Quantum that differed from the duties that Defendants owed to Apex. The Court, therefore, concludes Quantum does not have standing to assert RICO claims based on the allegations in paragraphs 76(b)-(d) of the First Amended Complaint.

In summary, the Court concludes Quantum's allegations in paragraph 76(a) of the First Amended Complaint do not support Quantum's RICO claims because such allegations are not predicate acts that support a claim under the PSLRA and/or RICO. The Court also concludes Quantum does not have standing to assert a RICO claim based on the allegations in paragraphs 76(b)-(d) of the First Amended Complaint.

Accordingly, the Court grants Defendants' Motions to Dismiss

as to Quantum's RICO claims.<sup>4</sup>

**III. Quantum has not pled its claim for fraudulent inducement with sufficient particularity.**

As noted, Federal Rule of Civil Procedure 9(b) requires all allegations of fraud to be stated "with particularity." In order to satisfy the additional burdens imposed by Rule 9(b), the plaintiff must allege "the time, place and nature of the alleged fraudulent activities." *Fecht v. Price Co.*, 70 F.3d 1078, 1082 (9<sup>th</sup> Cir. 1995)(quotation omitted). In addition, Rule 9(b)

does not allow a complaint to merely lump multiple defendants together but require[s] plaintiffs to differentiate their allegations when suing more than one defendant . . . and inform each defendant separately of the allegations surrounding his alleged participation in the fraud.

*Swartz*, 476 F.3d at 764-65 (quotation omitted). "In the context of a fraud suit involving multiple defendants, a plaintiff must, at a minimum, 'identif[y] the role of [each] defendant[ ] in the alleged fraudulent scheme.'" *Id.* at 765 (quoting *Moore*, 885 F.2d at 541).

In its fraudulent-inducement claim, Quantum alleges in pertinent part that "Defendants made material misrepresentations of fact, or omitted to state material facts, with the intent to

---

<sup>4</sup> Because the Court concludes Quantum has not adequately pled facts sufficient to support its RICO claims, the Court need not decide whether Quantum pled its RICO claims with the specificity required by Rule 9(b). The Court notes, however, if it were to address that issue, it is likely the Court would conclude Quantum has not satisfied the requirements of Rule 9(b).

induce Quantum to enter into the transaction." Quantum incorporates by reference paragraphs 1-43 of the First Amended Complaint to support its claim. Even if Rule 9(b) required Defendants to sift through 43 paragraphs of the First Amended Complaint in an effort to identify the allegations that support Quantum's fraudulent-inducement claim, the First Amended Complaint fails to provide the level of specificity required by Rule 9(b). For example, Quantum alleges in paragraph 16 that "ABCO and the Individual Defendants, shortly before Quantum voted its shares in Primitive to approve the transaction, represented to Quantum that ABCO had the personnel, experience and skill necessary to perform the services required by the services agreement. . . . [T]his representation was false." Quantum does not identify the date or place of the representation or the Defendant who made the representation with sufficient specificity. In addition, Quantum does not plead any facts to show that Defendants knew the representation was false at the time it was made in contrast to the possibility that Defendants may have honestly misjudged ABCO's ability to perform or that some other circumstance prohibited performance. See *Yourish v. Cal. Amplifier*, 191 F.3d 983, 993 (9<sup>th</sup> Cir. 1999) (the plaintiff must "set forth, as part of the circumstances constituting fraud, an explanation as to why the disputed statement was untrue or misleading when made. This falsity requirement can be satisfied

by pointing to inconsistent contemporaneous statements or information (such as internal reports) which were made by or available to the defendants." Quotations omitted.)).

The Court concludes Quantum has not pled its claim for fraudulent inducement with the level of particularity required by Rule 9(b). Accordingly, the Court grants Defendants' Motions to Dismiss as to Quantum's fraudulent-inducement claim.

#### **IV. Quantum's Third, Fourth, and Fifth Claims.**

Defendants move to dismiss Quantum's Third, Fourth, and Fifth Claims for abuse of control, gross mismanagement, and waste of corporate assets respectively on the ground that these claims are subsumed within Quantum's Second Claim for breach of fiduciary duty. Because the Court has concluded Quantum does not fairly and adequately represent the interest of Apex's shareholders with respect to Quantum's derivative claims, the Court need not address Defendants' argument as to whether Quantum's Third, Fourth, and Fifth Claims are subsumed in Quantum's Second Claim.

#### **V. Leave to amend.**

As noted, when the court dismisses a claim pursuant to Rule 12(b)(6), Rule 9(b), or Rule 23.1, leave to amend should be granted unless the court determines the allegation of other facts consistent with the operative pleading could not possibly cure the deficiency. *Schreiber Distrib. Co. v. Serv-Well Furniture*

*Co.*, 806 F.2d 1393, 1401 (9<sup>th</sup> Cir. 1986). See also *Reddy v. Litton Indus.*, 912 F.2d 291 (9<sup>th</sup> Cir. 1990), *cert. denied*, 502 U.S. 921 (1991); *In re Openwave Sys. Inc. Shareholder Derivative Litig.*, 503 F. Supp. 2d 1341, 1351 (N.D. Cal. 2007)(dismissed complaint for failure to meet the requirements of Rule 23.1 with leave to amend complaint).

**A. Quantum's derivative claims.**

The Court has concluded Quantum does not fairly and adequately represent the interests of Apex's other shareholders. In its supplemental brief, Quantum asserts if it were allowed to file a Second Amended Complaint, it would assert facts that show other shareholders support Quantum's efforts to rescind Apex's stock transfer and to include more specific allegations about the inadequacy of the investigation by the SIC.

Based on these assertions, the Court grants Quantum leave to amend its First Amended Complaint to cure the deficiencies with respect to Quantum's derivative claims noted by Plaintiff in its supplemental materials.

**B. Quantum's RICO claims.**

In *Swartz*, the Ninth Circuit upheld the district court's dismissal of the plaintiff's RICO claim with prejudice and without leave to amend. 476 F.3d at 761. The Ninth Circuit noted the district court concluded the plaintiff's RICO claim was based on predicate acts that were "in connection with" the sale

of stock and, therefore, "could not form the basis of a RICO claim under section 107 of the [PSLRA]." *Id.* The Ninth Circuit agreed with the district court's conclusion and noted in response to the plaintiff's request to amend its complaint that because "the PSLRA bar would apply under any internally consistent set of facts, it would be futile to amend the RICO claim. Consequently, it was not error to dismiss this claim with prejudice." *Id.*

The facts here are similar to those in *Swartz* in that any internally consistent set of facts that Quantum could plead to support its RICO claim would either be barred by the PSLRA or by *Sparling* because Quantum's injury is derivative of the alleged injury to Apex. In addition, Quantum did not assert it could cure these deficiencies in its supplemental briefing.

Accordingly, the Court declines to allow Quantum to amend its First Amended Complaint as to its RICO claims on the ground that it would be futile.

**C. Quantum's claim for fraudulent inducement.**

The Court dismisses Quantum's claim for fraudulent inducement for failure to plead fraud with the requisite particularity.

Accordingly, the Court grants Quantum leave to amend its First Amended Complaint to cure the deficiencies noted with respect to Quantum's fraudulent-inducement claim.

**CONCLUSION**

For these reasons, the Court **GRANTS** the Motion to Dismiss (#14) of Nominal Defendant Apex; **GRANTS in part** and **DENIES in part** the Motion to Strike (#13) of Defendants Baker Group LLP and Baker; **GRANTS in part** and **DENIES in part** the Motion to Strike (#18) of Defendants Altman Browning and Company, Altman, and Browning; **GRANTS** the Motion to Dismiss (#13) of Defendants Baker Group LLP and Baker; and **GRANTS** the Motion to Dismiss (#18) of Defendants Altman Browning and Company, Altman, and Browning.

The Court also **GRANTS** Quantum leave to amend its First Amended Complaint no later than November 1, 2008, for the purpose of curing the deficiencies noted in this Opinion and Order as to Quantum's derivative claims and its fraudulent-inducement claim.

IT IS SO ORDERED.

DATED this 2nd day of October, 2008.

/s/ Anna J. Brown

---

ANNA J. BROWN  
United States District Judge